RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Jan. 11, 1989 **LETTER 1008**

Dec. 30 DJIA 2168.57; PTI 2822; A-D Ratio -12.00
Jan. 6 DJIA 2194.29; PTI 2830; A-D Ratio -11.38
Dow Yield: 3.66%; Dow P/E: 12.1; DowPow: 763
Dow Book Value: 1008; Dow 200-day MA: 2082
Percentage of Undervalued Blue-chips: 21%

COMPOUNDING: There used to be two "impossible" (un-cut-able) items in the federal budget -- defense and Social Security. For years I've been warning that there is a third impossible item in our future. That third item has now arrived -- it's interest on the federal debt, and it's compounding as you read this report. Interest now accounts for better than 14% of the entire $1 trillion federal budget. Here are the Congressional Budget Office's projections for interest costs on the federal debt in the coming years:

$178 billion in fiscal 1990.
$188 billion in 1991.
$192 billion in 1992.
$198 billion in 1993.
$ 202 Billion in 1994.

And with interest rates rising (which they are) the over-$200 billion level could arrive well ahead of schedule (each 1% rise in interest rates costs the government an additional $5 billion). Thus, the continuing deficits and the compounding "debt-monster" are beginning to eat this nation up alive. That is, unless you think $3.4 billion a week in interest costs aren't something to fret about.

THE PICTURE: The bulls point out that investors' sentiment is now extremely bearish, characteristic of a market bottom. Furthermore, they note that there are mountains of cash on the sidelines, a phenomenon also characteristic of a market bottom. Finally, they state that the short interest on the NYSE is huge, again characteristic of important market bottoms. This market, claim the bulls, has already discounted a good deal of trouble.

I'm not going to argue with any of the above. I'm simply going to say that the operative fact is this: the primary trend of the market is down, and we're in the first phase of a major bear market. Cash on the sidelines may trigger a rally, too much pessimism can fuel an advance, a high short interest can bring on higher prices. But in all of these we're simply talking about rallies within the overall context of a major bear market.

I've said this before, but I'll repeat it. Those experienced or intrepid traders who want to try to beat the bear are free to try. But if you do want to "beat the bear," I suggest that you make full use of my Primary Trend Index (PTI) seen on page 2. The PTI is still holding well above its moving average and as long as it does so it is telling us that there is upward pressure in the market -- even though in a primary sense the bull market has ended.

The Big Picture: The bull market topped out in August 1987 at 2722.42 on the D-J Industrial Average and 1101.16 on the Transports. That was high tide for the stock market, and those are the high water marks. Since then, successive secondary (bullish) waves have washed over Wall Street, but so far, in 15 months of trying, the Dow has not been able to recover even half of its early bear market losses (i.e., the losses from the August 1987 high to the October crash low).

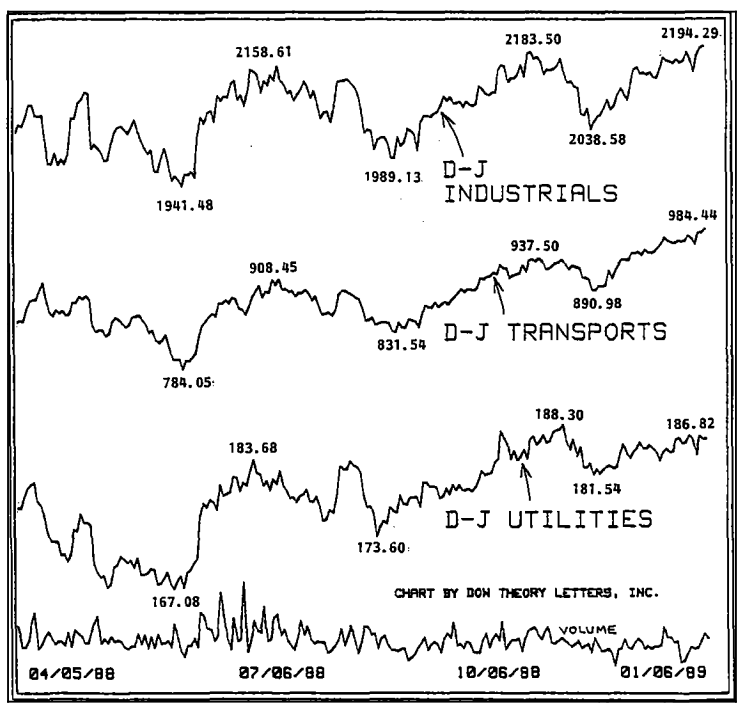
I said at the onset of this bear market that it was going to be a long, difficult, and deceptive affair. I wrote that it would try our patience and batter our nerves. I noted that the 1973-74 bear market was relatively easy to follow, and that by the "rule of alternation" this bear market was fated to be a much more difficult and deceptive one. A lot of my subscribers were with me during 1966 to 1974, one of the toughest periods in stock market history. I've said this before, but it bears repeating -- I'm beginning to wonder whether we're not seeing another such period now.

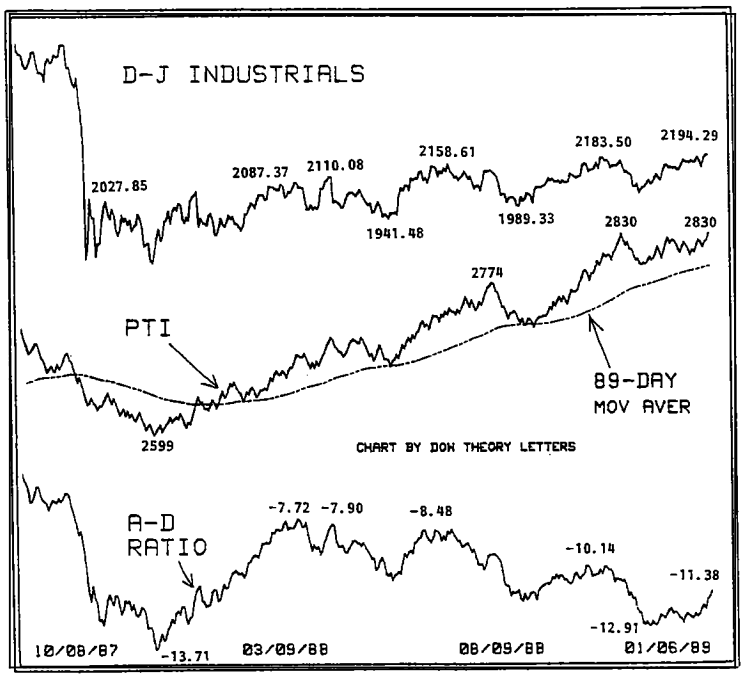
To recount a bit of history the market topped out in February of 1966, but there followed an extended period of major swings -- repeated swings up to the 1,000 area on the Dow and then down to 744 in late-1966, down in 1969 to 769, down to Dow 631 in 1970. Then in January 1973 we witnessed an advance to a record Dow high of 1051. Finally, during 1973-74, the puzzle ended with the market collapsing across the board and the Dow finding its ultimate bear market low at 577.

What of today? It seems to me that what we're seeing today is a market and an economy that are see-sawing on either side of a tenuous equilibrium (but giving the **illusion of stability**). The forces of inflation and deflation are now pressing against each other -- head to head. The inflationary forces are buoyed by very high factory utilization, a global boom (among the developed nations), heavy consumer buying, a weak or "bargain" dollar, a tremendous leveraging of debt, and a frenzy of speculation mostly concentrated on corporate takeovers and leveraged buyouts.

Opposing the inflationary forces, we have steadily rising interest rates, an almost unmanageable amount of debt service in the US and in the under-developed nations, a Fed (joined by central banks in almost all the developed nations) that is fearful of inflation, an abundance of almost all raw materials, plus a downturn in the so-called "long wave" or Kondratieff wave.

Thus the opposing forces of inflation and deflation are locked in a struggle that makes for a stock market that is both volatile and





erratic. The speculative intensity is there, but the doubts are also there. The underlying frenzy is there (we see it in the takeover stocks), but the possibility of disaster is also there. Add it all up and you have -- Wall Street -- 1989.

Near-term, it is notable that last week Fed Funds went over 9%. At the same time (totally liquid and safe) money market funds went well above 8% in yield, muni money funds (fully tax-free) pushed above 6% while the yield on the Dow was down to 3.66%.

Last week the ratio of T-bill yields to the Dow yield rose to 2.3 (i.e., T-bills yielding 2.3 times the Dow's yield of 3.66%), and this puts this ratio well into the historical "sell" zone for stocks (see last Letter). Finally, only 21% of the NYSE's blue-chip issues are now in the "undervalued" category -- a percentage characteristic of a market in a top area.

As for price action, on January 5 the Dow rallied to close at 2190.54 -- above the old October 21 peak and at a new post-crash recovery high. In so doing, the Dow finally confirmed the series of new recovery highs in the Transportation Average. This is the fifth time since the crash that we have had joint new highs in the two Dow components. In each previous instance in this bear rally, new highs have been followed by sudden declines.

So the question is, will it be different this time? As I see it, the Dow confirmation came after seven weeks of mild rally, and the confirmation also occurred within the context of a market that is over-bought. So whether there will be any real follow-up to this rally remains to be seen.

* *

To review a bit, what was the story for 1988? The fact is that for the average investor it was a much more difficult year than what was implied by the newspapers and magazines. Last year saw an extended and selective blue-chip advance. The majority of NYSE issues topped out in the first quarter, at which time the A-D ratio hit its high for the year. From then on it was all downhill for the A-D ratio, so that by the end of the year the A-D was (incredibly) within 1.2 points of its extreme (Dec. 4, 1987) bear market low. As far as the broad S&P 500 was concerned, this Index was up 12.4% for the year. But if we factor out the takeover stocks, the S&P was up only 7.2%. So 1988 was hardly a market to make money in. The fact is that it was not even an impressive bear market rally-year.

One of the things I've learned in my years (decades, I'm afraid) of watching the markets is that you've got to give the market it's head. You've got to let the market tell its story. People (and analysts) tend to fight the trend. They get impatient and do crazy things like buying bull market corrections or shorting bear market rallies.

Ultimately, and I have written about this extensively, the primary tide will overcome all (as it did during 1973-74), and the bear will have his way. Result: stocks will be driven down to bargain levels. What do I mean by bargain levels? Well, for one thing I don't mean stocks selling at 2.2 times book value (which is where they are selling now). And I don't mean stocks yielding 3.66% (which is what the S&P 500 and the Dow are yielding now). No, this bear market will ultimately take stocks down to around actual book value or below, at which point the Dow will also be yielding a juicy 6% or more.

Thus, the overriding consideration as far as investors are concerned is that the stock market is now traveling along the long path which will take it from the mini-yields and high excitement of late-1987 to an area somewhere ahead where there will be gloom and doom, massive losses, a give-up philosophy -- and **great values** in blue-chip stocks.

"But," you ask, "If the blue-chip stocks are to offer "great values" at the bear market bottom, what in the world will be secondary stocks be doing?" And my answer is that at the bear market bottom the secondary stocks will be decimated. They will be generating losses instead of profits and selling at mere fractions of their current prices. Let me put it this way -- you won't be looking at the secondary stocks when this bear market hits bottom. The reason is that you'll be offered all the blue-chip, dividend-paying issues you need at prices that will seem fantastic when compared to today's over-priced beauties.

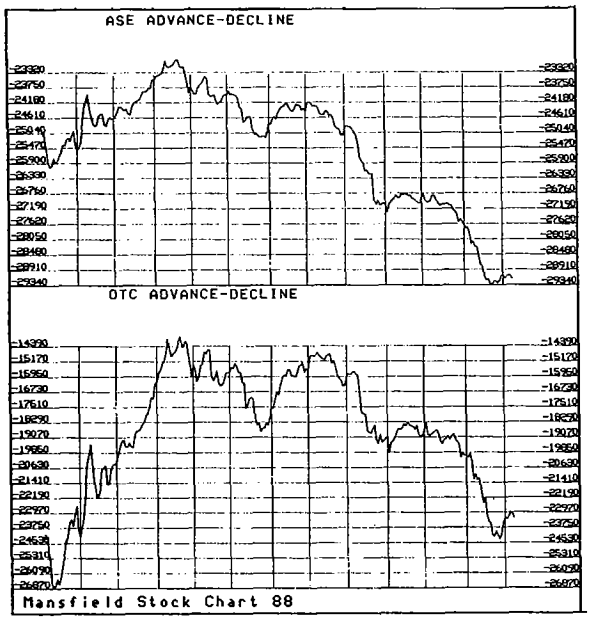
I've shown the advance-decline line ratio for the NYSE on page 2 of each issue of Dow Theory Letters. But here are the A-D lines for both the AMEX and the OTC (charts courtesy of *Mansfield Charts*). Here you can see how the bear has been sending the majority of stocks to lower levels, even while the Dow and the blue-chips have tended to "look good." (See charts page 3.)

INVESTMENT POSITION: I've spent the last few days re-reading my reports and George Schaefer's reports during the difficult and frustrating period of 1966-74. The thing that hits me as I reviewed those letters was that during all that period analysts pulled their hair out trying to beat the market as it swung back and forth between 630 and 1000. Finally, when the bear market wound up in its 1973-74 debacle almost everyone (except those of us who were out of stocks) lost their shirts as 90% of all stocks were smashed to unheard-of low prices (and great values).

In retrospect, the great majority of investors, both amateur and professional, would have been better off if they had just stayed in T-bills (while avoiding the stress) and loaded up with great values at the final bear market bottom.

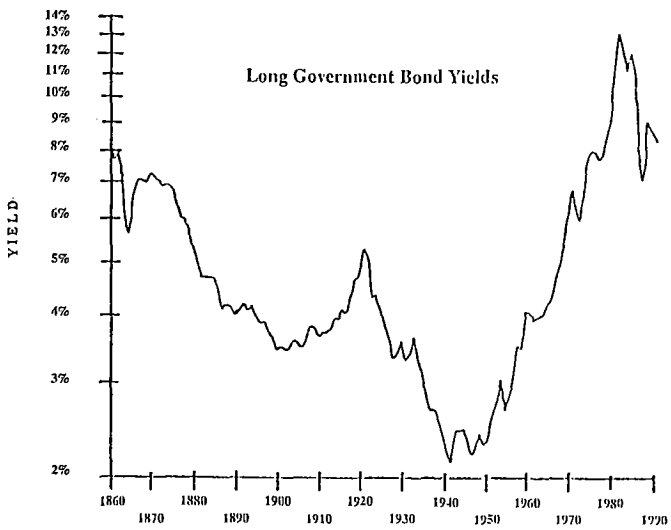
Experience is the great teacher, and I'm thinking that the lessons of 1966-74 apply very much to today's market. Throughout history the total return for common stocks runs around 10%. So here, today, we can buy safe, government-guaranteed two-year notes yielding 9%. Is it worth trying to beat the bear? Each man has to kill his own snakes, and I've decided that I'm perfectly happy pulling in a fat return on T-notes and muni cash funds rather than trying to beat the bear.

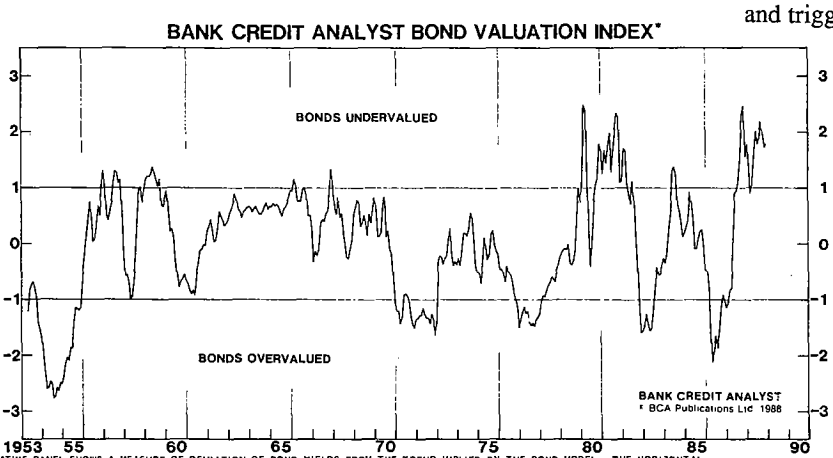
Nevertheless, as I've said before, you've got my PTI, and if subscribers want to try to "beat the bear" I can't blame them. I have a lot of subscribers, and each of them have different temperaments, psyches and needs. I'm not a nurse maid, and I can't tell you how to run your life or your investments. I provide the info you need to make the decisions.



BONDS, MONEY RATES: I've been writing about interest rates and their current severe competition with stocks. In the last Letter I included two charts showing that at current rates stocks were very overpriced compared with short-term money instruments (i.e., T-bills).

But what about long-term money? What about bonds? The fact is that I've been advocating the purchase of high-grade bonds for the past three years, and even more strongly advocating high-grade bonds since the 1987 crash.





Ask a dozen analysts their opinions about bonds, and you'll get a dozen different answers (mostly hedged). In the past I've included many charts showing that the long-term bear market in bonds has been reversed on a trend basis.

The accompanying chart (courtesy of *Ceres Capital Corp.*) traces bond yields going back to the 1860s on a ratio scale chart. Note the extreme length (in duration) of the yield trends. The decine in rates from 1920 to 1942 took 22 years, the rise in rates from 1942 to 1980 took 38 years.

As I've stated before, the explosion to the 1980 peak in rates looks climactic to me. Furthermore, the whole area around 1980 has the look of a massive spear-point TOP. Since the 14% rates of 1980, the long-term rates have come down precipitously. Today, even though there is much-voiced fear of inflation, the long-term Treasury bond yields are only in the 9% area.

The next chart is from the latest report by the authoritative *Bank Credit Analyst* (514 398 0655). The *BCA* uses a model of projected interest rates, and the Bond Valuation Chart shows the deviations from their projections. In the past *BCA*'s interest rate projections have been very accurate, and therefore this chart is of major importance. What the chart shows is a degree of undervaluation that has occurred only once before in the last 35 years, and that was in the period around 1980.

The *BCA* believes that there is a better than 50/50 chance of a "recession or severe slowdown by around mid-year." They continue, "We think the risks of negative shocks to the economy are much greater than the chances of positive shocks. . . . There is nothing in the models that indicates, in advance, the depth of a recession. But there are plenty of disturbing signs. The underlying trend of the world economy is deflationary. There is a risk of a substantial credit squeeze. The Fed may not be able to ease quickly after a downturn if the budget deficit is rising again and the dollar is crumbling. Debt levels are at record levels. There are significant risks of a severe recession."

What would happen when the next recession hits? This is in the realm of the great economic unknown. One theory advanced by the extreme pessimists is that the federal (and state) deficits would sail off the top of the charts, thereby generating an "interest rate" spike as everyone and his brother rushed to borrow money in order to remain solvent or at least in order to remain in business.

The other view is that a recession would be fought tooth and nail by the Fed, and that interest rates (i.e., Fed funds and the discount rate) would be brought down to as low a level as possible.

The *BCA* takes note of all this and states that "If we assume that the Fed maintains a fairly aggressive posture and avoids a full-fledged dollar crisis, short rates could rise another 150 basis points. Even if long rates move up another 50 basis points to 9 3/4%, you would have an inverted yield curve, probably sufficient to hold the dollar and trigger a decline in domestic demand required by the US. The bigger the rise in short rates, the greater the chances of a major bull market in bonds in 1989-90."

My own feelings and conclusions about the bond and money markets are as follows:

(1) I think the fairly high short-term rates are due to the pressures of a booming economy plus the desire on the part of the Fed to keep the dollar attractive to foreign buyers and holders.

(2) Despite the powerful rise in short-term rates, longer-term rates have risen very little. I think this has occurred because the bond market is discounting business contraction and a recession somewhere ahead -- probably during 1989. Therefore, although the short-term market seems to be dealing with the possibility of inflation, the bond market (which looks

further ahead and is not manipulated by the Fed) is not worried about inflation and is actually more worried about recession and deflation.

(3) I think there is a chance of an interest rate spike which would arrive somewhere between today and the onset of the next recession. But I think the chances of such a spike are less than 50/50. On this basis, I feel bonds are a definite value in this area.

(4) Certainly, bonds are a great value when compared with stocks. The yield spread in favor of high-grade bonds over stocks is now around 5.7%. In the face of an economic expansion which is ancient by historical standards, the yield spread in bonds over stocks make them far preferable on a value basis to stocks. Furthermore, as stated in the opening part of this section, I believe that bonds are in the early part of a major bond bull market.

Stanley Salvigsen manages Comstock Partners Strategy Fund ($1.2 billion), Dreyfus Capital Value Fund ($500 million) plus $300 million in advisory accounts. He is known as a very shrewd advisor and a man who tends to be right. Salvigsen notes that almost every area of excess credit from stocks to oil has been hit over recent years by a major credit crush -- except for housing. Salvigsen believes that housing is overpriced, that there is an oversupply, and that housing is in for trouble ahead.

When asked what item could be used as a hedge against falling home prices (in other words, deflation) Salvigsen anwered, "The only way is to own long-term bonds." Salvigsen owns no corporate bonds, but he does own Treasuries, loads of them. Salvigsen estimates that his firm owns 1.5% of the total supply of long-term T-bonds. Says Salvigsen, "The next big shortage is coupon -- quality coupon. The real risk out there is reinvestment risk, the possibility of not being able to earn as much -- as interest rates decline."

You want a super-contrary view. There it is. I think it's a view that requires a long-term investment outlook -- but I think it's an intelligent view, and I personally wouldn't argue with it. (Thanks to Scott Burns, *Media General Financial Weekly* for many of the facts on Salvigsen.)

QUESTIONS and ANSWERS: Question: Russell, you have written a lot in the past about compounding. In this Letter you write about the negative effect of the compounding interest on the national debt. What about the positive effects of compounding?

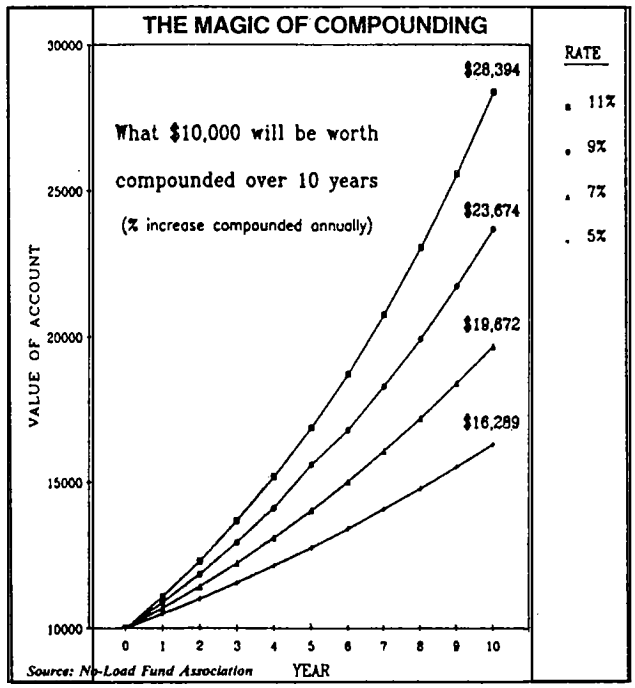
For the benefit of new subscribers, compounding is the safe and royal road to riches. There are two flies in the compounding ointment, however. One is taxes, the second is inflation. Therefore, those who choose the compounding road to wealth must always keep these two bugaboos in mind.

Municipal bonds can solve the tax problem, but not the inflation problem. One solution is to buy municipal bonds with an unswerving policy of reinvesting the interest in gold coins and stocks. If this is done as a definite policy, one can almost eliminate the timing factor (in other words, you buy gold coins and blue-chip stocks regardless of whether the respective markets are moving up or down).

The power of compound interest is illustrated in the chart above. Parents often ask me what to suggest as far as reading matter for their young investment-minded sons and daughters. Unhesitatingly, I tell them to buy any book on the compound interest tables. "The Dow Jones Irwin Guide to Interest" is an excellent book and should be in every investor's library.

Question: A good deal is written these days about confirmation in the Averages. What's the story here?

Answer: According to Dow Theory, a movement of a single Average, unconfirmed by the other, is meaningless for prediction purposes and more often than not -- deceptive. When discussing



"the Averages," the Dow Theory always refers specifically to the D-J Industrial and Transportation Averages. The Utility Average (which came into being in 1929) is not used in classic Dow Theory. Nevertheless, I find the path of the Utility Average to be useful, and in recent history the Utilities have tended to move ahead, often far ahead, of the other Averages.

Robert Rhea, the great Dow Theorist of the 1930s, considered any penetration of 0.01 or more of a preceding level as a valid penetration. However, Rhea also felt that a penetration (i.e., confirmation) was much more authoritative if it was accompanied by rising volume. Furthermore, he felt that the closer together (in time) a confirmation, the more authoritative the confirmation. In other words, if the Industrials and Transports both push through previous highs on the same day, such a move carries much more authority than an instance where one Average rallies to a new high and two months later the other confirms. I might add that upside confirmations in bear markets are far less trustworthy than upside confirmations (in harmony with the primary trend) in bull markets.

Question: What about the Utility Average as a confirmatory tool?

Answer: As explained earlier, I don't use the Utility Average as a confirming indicator, although I am always careful to watch what the Utilities do. There is one item I should add as far as Utilities are concerned. Many years ago I published studies of the the joint action of the D-J Utility Average and the D-J Bond Average. I have seldom seen a period in which a joint move by BOTH the Utility and Bond Averages was not joined by the rest of the market -- either on the upside or the downside. To put it another way, when the Utility and Bond Averages are moving together on a trend basis, it's a near-sure thing that the major averages will follow.

Question: How much credence do you give to the so-called "year-end forecasts?"

Answer: Very little. But I do watch for consensus opinions. For instance, the January 3 *Wall Street Journal* polled 38 leading economists regarding the coming year. The consensus opinion among the 38 polled was that 1989 will be an up-year. Of the 38, all saw a rise in GNP for the first half of 1989 and only three of the 38 predicted even a slight decline in GNP for the second half. And obviously I wonder, "Can all these guys be right?"

Question: I note that you frequently talk about home prices in these reports. How important is the real estate market in your analyses?

Answer: VERY, very important. Note this -- of the $5.8 billion in private debt in the US, $3 billion is represented by mortgage debt. The great bulk of the American's public's "savings" lies in the

value of their homes. In fact, it is thought that the minuscule saving rate among Americans may be due to their feeling that they are already well protected by (1) Social Security and (2) the equity in their homes (which for years has been rising). Thus, it is easy to see how important the real estate/home syndrome is for the American economy. Any across-the-board national slide in home prices could produce severe economic consequences.

NOTES & QUOTES: Have you ever seen anyone disappear the way Dukakis has? Did he ever really exist? The only Dukakis item that hasn't disappeared is Massachusett's budget deficit-mess. On January 3 the Duke announced to the world that he would not run for governor again, although said he might run again for the White House.

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How will history grade President Reagan? It's obviously too early to tell. I was a Reagan man, but six months after he was in office I became disillusioned. Reagan had a single outstanding talent-- he was a great communicator. But he wasted his talent. He never led the nation to accept any difficult choices, and in almost every instance Reagan himself took the easy path. When anything came up that could damage his popularity, he would drop it. Few people realize it, but not once did Reagan present a balanced budgedt As far as Reagan was concerned, it was always "morning in America."

Here's my final appraisal. Booms and recessions are a fact of life, and they will always be with us. But when Reagan leaves office this nation will be fundamentally WEAKER than when he took office. Today the debts are huge, the deficits are massive, savings are inadequate, the currency is sick, the financial system is illiquid, and the military is over its head in weapons that don't work or that the nation can't afford. In the end, I consider Reagan probably the luckiest president in US history. He never had to face any of the consequences of his actions or inactions.

Now comes George Bush. Bush, unlike Reagan, is a Washington insider. He knows Washington and he's a veteran of Congress. But the budget fight lies ahead, along with Bush's promise to the American people not to raise taxes. This is from a Dec. 6 *New York Times* article: "Even if the Democratic leadership decided to take the lead on taxes, it is unlikely that they could get enough of their membership to follow suit. 'A lot of the House feel that they got set up by Reagan,' said one Democratic staff member. 'They're still spooked by the early 80's. And if tomorrow Jim Wright came out and said, I'm pushing for taxes, I don't think he could muster up a majority. It's going to have to come right from George Bush's lips.'

"At the same time Democrats worry that their party will once again be seen as as the party of higher taxes. Argued one Democrat strategist, 'There's no mileage right now to advancing sensible budget proposals. That's sad but it's political reality, and the Democrats have got to learn that lesson. We've got eight years of playing experience under Reagan, so we feel pretty confident.' "

Russell comment: 1989 is shaping up as another tough year for honest people. And when are they going to limit the years that Congressmen can hold office? At each election 90% of these office-hungry incumbents (LaGuardia called them "political bums") are reelected to Congress. Give us a break.

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I never liked zero-coupon bonds. I don't like them because you get no return (interest) until the bonds mature. This prevents one from diversifying with the income (something I always tell bond holders to do). Furthermore, zero's can be extremely volatile. For instance, a one percent rise in interest rates will cut the value of a 30-year zero by 30%.

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Want to win a bet? Ask a rich buddy if he can name the US's southern-most city. Answer: Honolulu.

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The third world still owes its creditors $1.3 trillion. US banks are still owed $81 billion. The principal and interest on these debts must be paid in dollars. Meanwhile, inflation is rampant in many of the debtor nations. For instance, last year prices rose 933% in Brazil. In Peru the inflation rate is currently 1700%. Thus, to pay back their debts (in dollars) is not only ridiculous, it's impossible. It's only a matter of time, I believe, until we get official "forget its" on these debts.

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The big broadcasters are having a tough time, but if you hit it right in TV production you can make mighty big bucks. Marcy Carsey and Tom Werner are the hottest TV producers in Hollywood with the "Cosby show," "A Different World" and "Roseanne," three of the top shows. Get this — last year gross proceeds from Cosby Show rerun rights to local stations were estimated at half a billion dollars. That's right, half a billion.

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San Diego is coming of age. For the first time in history, murders in San Diego have out-stripped traffic fatalities. We've had 111 killed in traffic this year and 142 murders.

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Speaking of San Diego, a British-led combine just purchased San Diego's tallest building (Symphony Tower, a 34-story office building complex) for $164 million. Meanwhile, the Japanese (having bought the Exxon headquarters, the ABC headquarters, the US News & World Report headquarters and the Arco complex) are in the process of buying the Sears Tower, which is the world's tallest skyscraper (price around $1.2 billion). It is reported that the Japanese group would like a bit of US participation in the deal so that it doesn't look like the Japanese alone are buying up most of America.

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US/Japan: The American Council on Education notes that of this country's 3.8 million 18-year-olds, 37% are educational failures -- 700,000 dropped out of school and another 700,000 can't read their diplomas. "It's an absolute disaster," says David Kearns, chairman of Xerox and co-author of "Winning the Brain Race." He adds, "And we, as a nation, can't compete unless something's done about it." US companies are now spending $25 billion a year teaching basic skills that their employees should have learned in school. In Japan 95% of the population graduate from high school, and high school in Japan is equivalent to many US junior colleges.

* *

Dun & Bradstreet's new 1989 "*Guide to Your Investments*" (written by my good friend, Nancy Dunnan) is a treasure-trove of useful and valuable information. The soft-cover book sells for $10.95, and it covers everything from baseball cards to estate jewelry to techical analysis to corporate balance sheets. Nancy, how do you do it all? And I think I work hard!

* *

According to the National Science Foundation (a federal agency), Japan's scientific enterprise has grown so vigorously that it has achieved "relative parity" with that of the US. Japan now spends a larger portion of its GNP on civilian research than the US does, and in some areas "Japan's performance has exceeded that of the US." Areas where Japan now leads the US are in radio, TV equipment, communications gear, office machines, computers, and scientific instruments.

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So far since the crash, more than 17,000 jobs have been lost in the securities industry, and the drying up of business is now affecting students who are in business schools. Said Doritt Cowan, in charge of placements for Baruch College in NYC, "For the most part they're thinking, 'Let's get out of here and go to law school.' " Many Wall Streeters believe the securities industry is still bloated, the general figure being by about 25%. Biggest lay-offs since the crash (mostly in NYC) are Shearson Lehman 6,000, Merrill Lynch 3,600, Kidder Peabody 1,000, Salomon 800, L.F. Rothschild 700, First Boston 550. Wall Street, as usual, takes the first beating from the bear.

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I wouldn't be surprised if within three or four years (maybe less) *Dow Theory Letters* will be sent out largely via FAX. The Post Office is government-run (read inefficiently-run) and the price of first-class postage keeps rising. But the telephone companies are run for profit, which means they tend to be efficient. So I expect the price of FAX to finally drop below the price of a first-class letter. When that happens the PO is going to have to face bitter reality, and the fact is that already most of what the PO does is transporting greeting cards and checks. But I feel the trend is strongly against the PO. FAX, in a short time, will offer murderous

competition, both in deliver time and in dollars and cents. (Item: half of all the phones in Japan have connecting FAXes.)

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Copper: My friend, Jon Strebler of Paine Webber in SD sends me his chart of copper. The metal appears to be topping out after following a parabolic curve up to its recent high above $1.60 per pound. Copper is considered a bellwether indicator of economic activity.

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After 30 years of business we've got all our subscribers on a sophisticated computer system. As a result we can finally see exactly what we're doing. And I guess I must be doing something right. Renewals to *Dow Theory Letters* are running at the rate of 84.8%. Therefore, I want to say a big "Thank You" to all my loyal subscribers (many of whom have been putting up with me for 20 years or longer).

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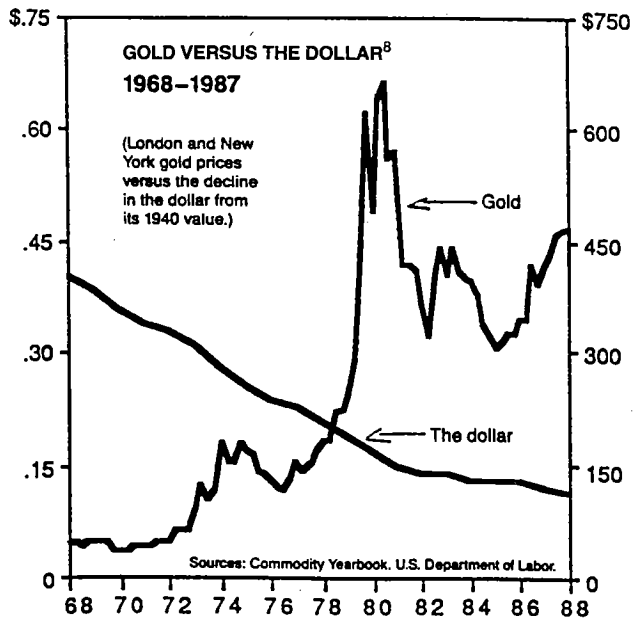
The Real-Estate Letter (2 Tripp St., Framingham, Mass. 01701) states that "people are fleeing high California prices" and this goes for "high-priced New York and Washington DC." They are moving into neighboring states where prices are lower. "New factories and offices and homes follow in the wake of shifting populations . . . this also guarantees that competition with such developing low-cost real estate areas will stop real estate inflation cold on the East and the West coasts . . . something almost no real estate economists have programmed into their computers as yet!"

GOLD: I opened this Letter with projections of the interest costs on the federal budget. Have you ever asked yourself, "Where is all the money coming from to pay for the deficits, the debts, and the compounding interest?" The answer is that the money will come from increases in the US money supply.

When the federal government spends more money than it takes in, we tend to get the phenomenon known as inflation. Inflation is not always visible at the time, but over a lengthy period, the ravages of inflation become only too clear. You see it in the price of housing, in the price of clothing, in the price of food, movie admissions, college tuition, you name it. To put it another way, the history of the dollar is that it buys less and less as the years go by.

What about gold? Why guess? Here's a chart put out by H.F. Langenberg (Newhard Cook & Co., 1600 S. Brentwood, St. Louis, MO 63144) in his "Fall Notes" booklet. The chart traces the catastrophic decline in the dollar's purchasing power since 1968. During the same period, gold actually increased in purchasing power.



As you can see, the dollar has been in steady decline over the past 20 years. Since 1968, it's lost about 70% of its value. But gold prices have been incredibly strong in comparison, gaining 1,088% from the 1968 price.

As the story goes, a one-ounce gold coin would buy a good man's suit back at the turn of the century, it would buy a good man's suit in 1940, and today a one-ounce gold coin will still buy a good man's suit.

Back in 1942 I was lucky enough to have a summer job (union job at that) loading trucks at the George Button Co. in NYC. They paid me $18.75 for a five-and-a-half day week (Saturdays, 8 to 12). I could buy a lunch then for 40 cents, a nice shirt for $1.25 and a Sunday newspaper for a nickel. That'll give you some idea of what has happened to the dollar over the last 46 years.

In those days the US didn't have anything like the debt it has today, and $178 billion a year in interest on the national debt would have been considered something out of Alice in Wonderland. So I continue to buy gold coins and, in fact, I've stepped up my purchases over the past month. Frankly, I couldn't care less where gold goes in the next year or so. I dont' care if gold goes to $300 or $200 or $700. I'm going to continue to collect gold coins until Mr. Bush or someone else convinces me that the US and the dollar are going to come out of this budget mess in a shape I can recognize. That's the way I see it, and if you know of a better and surer and safer store of value than gold -- please be kind enough to let me in on it.

Here's a story that you might find interesting and helpful. Many years ago I was talking to a friend who happened to be a psychoanalyst. We were talking about rich men and money and fear. And I remember that the Doc said: "When they're young, rich men-to-be are often afraid that they'll never make enough money. Then when they're older and they've actually made their fortunes, they're still afraid -- but now they're afraid that they'll lose their money."

This explains something about the psychology of wealth -- and the use of gold. Rich men (and women) are often more concerned with keeping their wealth (buying power) than they are with making more money. As these people get older they tend to get more conservative. They've seen more -- they've seen rich friends lose their money, they've seen "great investments" go down the drain, they've seen decades of inflation, they've seen many of "the best-laid plans of mice and men" go astray.

So as the years go by these people get respect for fine furniture, outstanding real estate, quality jewels or gold. But the "little guy" who watches to see whether gold goes up $5 today or down $10 next week, he doesn't understand this. He doesn't understand that 10 years from now or 20 years from now gold will still hold its value. He doesn't understand that the Maple Leaf that is sitting there in the coin shop will buy a suit at Saks Fifth today, and, that same gold coin in the year 2050 will still buy a suit at Saks Fifth (assuming that Saks Fifth is still around).

So if you can understand the above, you can understand why, in this age of rising piles of paper money, in this age of debt leverage, wise men buy gold and "put it away." These men don't need income, they want safety. They fear a loss of buying power and a decline in their living standard. They know they live in a rapidly changing world, a world where a once-powerful currency like the dollar can lose half its value versus other currencies in less than four years.

LATE NOTES: The Fed is holding back -- holding back, fingers crossed and hoping that inflation figures won't force them to boost the discount rate. Meanwhile, the stronger dollar is giving the Fed a little breathing space. But Fed funds at 9% plus is pressure enough. . . .The Dow is again pushing towards the halfway level of its entire August to October 1987 bear market decline. The exact halfway level is 2230. Failure to better Dow 2230 would be highly significant. As for values, the S&P 500 is now selling at 27.3 times its dividend, on the high and pricey side and indicating that stocks are anything but bargains (this is especially true in view of the high real rates provided by the competition -- money instruments). . . Meanwhile, Japan's Nikkei is at a new "yield-less" wonder-high of 30,675. Will the Nikkei be the storied tree that "grows to the sky?" Hold on to your seats -- and stay tuned.

NEXT MAILING: Jan. 25